

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1

REG-125071-06

RIN 1545-BF75

Reporting Rules for Widely Held Fixed Investment Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the **Federal Register**, the IRS and the Treasury Department are issuing final and temporary regulations amending §1.671-5 which provides reporting rules for widely held fixed investment trusts (WHFITs). The final and temporary regulations clarify and simplify reporting for trustees and middlemen of non-mortgage widely held fixed investment trusts (NMWHFITs). The text of those final and temporary regulations serves, in part, as the text of these proposed regulations. In addition to the amendments to §1.671-5 included in the final and temporary regulations, these proposed regulations provide for the creation of a directory of NMWHFITs and trustees of widely held mortgage trusts (WHMTs). These regulations also clarify the reporting rules for market discount under the NMWHFIT safe harbor for NMWHFITs that hold debt instruments with original issue discount (OID). The preamble to these regulations also solicits comments regarding the safe harbor for WHMTs.

DATES: Written or electronic comments and requests for a public hearing must be received by October 2, 2006.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-125071-06), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044, or send electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS and REG-125071-06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Faith Colson, (202) 622-3060 (not a toll-free number); concerning submission of comments and/or requests for a public hearing, Richard A Hurst at Richard.A.Hurst@irscounsel.treas.gov.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These proposed regulations amend §1.671-5. The collection of information contained in these proposed regulations has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1540. Response to this collection of information is mandatory. The collection of information in these proposed regulations is in §1.671-5. This information is required to be reported to beneficial owners of trust interests to enable them to correctly report their share of the items of income, deduction, and credit of the WHFIT in which they have invested. This information is also required to be reported to the IRS to enable the IRS to verify that trustees and

middlemen are accurately reporting information to beneficial owners of trust interests and that beneficial owners are properly reporting their ownership of a trust interest.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On January 24, 2006, the Internal Revenue Service (IRS) and the Treasury Department published final regulations (TD 9241) (final regulations) under §1.671-5 in the **Federal Register** (71 FR 4002) providing reporting rules for WHFITs. Final and temporary regulations in this issue of the **Federal Register** amend §1.671-5. These amendments are intended to clarify and simplify the reporting required by NMWHFITs under §1.671-5. The text of the final and temporary regulations also serves, in part, as the text of these proposed regulations. The preamble to final and temporary regulations explains the final and temporary regulations and those parts of these proposed regulations that are included in the final and temporary regulations. These proposed regulations include proposed amendments to §1.671-5 in addition to those provided by the

final and temporary regulations. The proposed amendments to §1.671-5 that are not included in the final and temporary regulations are discussed below.

I. Proposed Directory of WHMT Trustees and NMWHFITs and Requirement That WHMT trustees Provide a List of WHMTs for Which They act on an Internet Website.

Prior to the publication of the final regulations under §1.671-5, commentators expressed concern that middlemen would not be able to identify a client's investment as an investment in a WHFIT and suggested that the IRS publish a directory or list of WHFITs that would include the name and CUSIP number of each WHFIT, along with the name, address and telephone number of the WHFIT's representative. Commentators noted that a publicly available directory or list would assist middlemen and brokers in identifying a client's investment as an investment in a WHFIT and in locating the WHFIT's representative.

In response to these comments, the final regulations require a trustee to identify the WHFIT as either a WHMT or a NMWHFIT when providing trust information. The preamble to the final WHFIT regulations provides that the IRS and the Treasury Department are studying whether a directory or list of WHFITs can be compiled by the IRS and expressed concern that such a directory was not feasible because of the large number of WHMTs. In the preamble, the IRS and the Treasury Department requested additional comments from middlemen regarding the type of WHFITs that should be included in any directory, the type of information needed by middlemen (especially middlemen holding WHMT

interests), and the format of a directory that would be most helpful. Trustees were also asked to comment regarding how the IRS could obtain the trust information needed for the directory from the trustees in the least burdensome manner.

Since the publication of the final regulations, the IRS has received additional comments regarding the need for a directory of WHFITs. Commentators indicated that such a directory would significantly improve a middleman's ability to comply with §1.671-5 and suggested that the IRS provide a directory of WHMT trustees and NMWHFITs, with each WHMT trustee maintaining a list of the WHMTs for which the trustee acts at an Internet website available to middlemen.

In response to these comments, the IRS proposes to expand Publication 938, "Real Estate Investment Conduits (REMICs) Reporting Information (and other Collateralized Debt Obligations (CDOs))," or create a separate publication to list WHMT trustees and NMWHFITs. The IRS currently intends to list NMWHFITs in this directory by trustee (listed in alphabetical order) with the NMWHFITs for which the trustee acts listed by CUSIP number, followed by any NMWHFITs, listed in alphabetical order by name which do not have CUSIP numbers. NMWHFIT trustees will be required to file Form 8811, "Information Return for REMICs and Issuers of CDO's," or a similar form to provide the IRS with the information it needs to list NMWHFITs in the directory.

The directory will also alphabetically list WHMT trustees and provide the address of the Internet website that lists the WHMTs for which the trustee acts.

WHMT trustees will be required to file Form 8811, or similar form, to identify themselves to the IRS as a WHMT trustee and provide an Internet website that lists the WHMTs for which the trustee acts. The IRS and Treasury Department continue to request comments on the need for the directory and the format to be used for the directory, as well as comments regarding how to obtain information from trustees in the least burdensome manner.

II. Clarification of Market Discount Information Required to be Reported under the NMWHFIT Safe Harbor.

Commentators also noted the need for amendments to the information required to be reported under the NMWHFIT safe harbor with respect to market discount. If a NMWHFIT does not qualify for the reduced reporting in §1.671-5(c)(2)(iv)(B), §1.671-5(f)(1)(viii) requires the trustee to provide information regarding the portion of the trust that the assets sold represented. Assuming that a trust interest holder purchased its interest at a discount, it was contemplated that the trust interest holder would allocate the same portion of its discount to the sale as the assets represented to the NMWHFIT. The trust interest holder would then determine how much of the discount allocated to the sold assets had accrued since the trust interest holder purchased its interest using either a ratable or constant interest method, as appropriate.

After reviewing the comments received after the publication of TD 9241 (71 FR 4002), the IRS and the Treasury Department noted that the information required to be reported under the safe harbor is incomplete with respect to a NMWHFIT holding debt instruments with original issue discount (OID). Under both the general provisions (§1.671-5(c)(2)(ii)(A) and (vii)) and the safe harbor

(§1.671-5(f)(1)(vii) and (viii)), OID information is required to be calculated and provided separately from market discount. Accordingly, to enable trust interest holders to determine the amount of market discount the interest holder is to allocate to a particular sale or disposition of debt instruments by the NMWHFIT, §1.671-5(f)(1)(viii)(A) is proposed to be amended with respect to NMWHFITs that hold debt instruments with OID, to include a requirement that trustees provide the aggregate adjusted issue price of the debt instruments held by the NMWHFIT per trust interest as of the start-up date as well as of January 1 of each subsequent year of the NMWHFIT. It is contemplated that trust interest holders will use the January 1 adjusted issue price for the year in which the trust interest holder purchased its interest to determine whether a trust interest was acquired with market discount. So as not to require trustees to calculate information for calendar years prior to the effective date of the final regulations, the proposed regulations only apply this requirement to NMWHFITs with a start-up date (as defined in §1.671-5(b)(19)) after January 24, 2006.

III. Request for comments on the expansion of the WHMT safe harbor.

The final regulations include safe harbor reporting rules for WHMTs. Section 1.671-5(g)(1)(ii)(B) provides that, to be eligible to report under the WHMT safe harbor, all interests in the WHMT must represent the right to receive an equal pro-rata share of both the income and the principal payments received by the WHMT on the mortgages it holds and that, for example, a WHMT that holds or issues trust interests that qualify as stripped interests under section 1286 may not report under the safe harbor. Further, a WHMT that holds an interest in

another WHFIT is not eligible to report under the WHMT safe harbor. See §1.671-5(b)(11) (limiting the definition of a mortgage to exclude an interest in another WHFIT) and §1.671-5(g)(1)(ii)(E)(1) (providing that only WHMTs that directly hold mortgages may use the safe harbor). Since the publication of the final regulations, a commentator has requested that safe harbor reporting rules be developed for WHMTs that hold or issue stripped interests and for WHMTs that hold interests in other WHMTs. The IRS and the Treasury Department will consider this request in connection with further action on this proposed regulation and request additional comments regarding the need for additional WHMT safe harbor reporting rules, the nature of the arrangements for which the additional safe harbors are needed, the safe harbor reporting suggested and how such reporting is consistent with substantive law.

Effective Date

The IRS and the Treasury Department expect to take prompt action to finalize the proposed regulations so that certain of the provisions that are only included in the proposed regulations can be made effective as of January 1, 2007 (see §1.671-5(m)) as though the provisions were included in TD 9241. The IRS and Treasury Department invite recommendations regarding the effective date of proposed paragraphs (c)(3) (requiring trustees to file an information return with the IRS and requiring WHMT trustees to provide an Internet Website listing the WHMTs for which they act) and (c)(5) (providing for middlemen to refer to a directory created by the IRS), that may require some lead time for their implementation.

Special Analysis

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations will not to have a significant economic impact on small entities because the reporting burdens in these regulations will fall primarily on large brokerage firms, large banks, and other large entities acting as trustees or middlemen, most of which are not small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Thus, a substantial number of small entities are not expected to be affected. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in

writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Faith Colson, Office of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and Recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 – INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.671-5 is amended by:

1. Revising paragraphs (b)(5), (b)(8), and (b)(21).
2. Revising paragraphs (c)(2)(iv), (v)(C), (vi), and (vii).
3. Revising paragraph (c)(3).
4. Adding paragraph (c)(5)(iv).
5. Revising paragraphs (f)(1)(i)(A) and (viii)(A).

The revisions and addition read as follows:

§ 1.671-5 Reporting for widely held fixed investment trusts.

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(b) * * *

(5) [The text of proposed §1.671-5(b)(5) is the same as the text of §1.671-5T(b)(5) published elsewhere in this issue of the **Federal Register**].

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(8) [The text of proposed §1.671-5(b)(8) is the same as the text of §1.671-5T(b)(8) published elsewhere in this issue of the **Federal Register**].

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(21) [The text of proposed §1.671-5(b)(21) is the same as the text of §1.671-5T(b)(21) published elsewhere in this issue of the **Federal Register**].

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(c) * * *

(2) * * *

(iv) [The text of proposed §1.671-5(c)(2)(iv) is the same as the text of §1.671-5T(c)(2)(iv) published elsewhere in this issue of the **Federal Register**].

(v) * * *

(C) [The text of proposed §1.671-5(c)(2)(v)(C) is the same as the text of §1.671-5T(c)(2)(v)(C) published elsewhere in this issue of the **Federal Register**].

(vi) [The text of proposed §1.671-5(c)(2)(vi) is the same as the text of §1.671-5T(c)(2)(vi) published elsewhere in this issue of the **Federal Register**].

(vii) [The text of proposed §1.671-5(c)(2)(vii) is the same as the text of §1.671-5T(c)(2)(vii) published elsewhere in this issue of the **Federal Register**].

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(3) Requirement that trustees file an information return and that WHMT trustees list WHMTs on an Internet website--(i) Information return identifying a NMWHFIT to the IRS. For each NMWHFIT for which the trustee acts, the trustee of a NMWHFIT must file the form specified as the information return to be used for identifying a NMWHFIT to the IRS. The form must be filed by the due date provided by that form and must contain the information required to be provided by the form. If, following the publication of final regulations in the **Federal Register**, the IRS issues additional guidance that prescribes another method to be used to identify and provide information with respect to a NMWHFIT to the IRS, this method must be used.

(ii) Information return for trustees of WHMTs and the requirement that the trustee maintain an Internet website listing the CUSIP numbers and names of the WHMTs for which the trustee acts. The trustee of a NMWHFIT must file the form specified as the information return to be used for identifying the trustee to the IRS. The form must be filed by the due date provided by that form and contain the information required to be provided by the form. In addition, the trustee must maintain a list of the WHMTs for which the trustee acts on the trustee's Internet website (or another site designated by the trustee for this purpose). If, following the publication of final regulations in the **Federal Register**, the IRS issues additional guidance that prescribes another method to be used to identify a trustee as a WHMT trustee and provide information with respect to the WHMTs for which the trustee acts, this method must be used.

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(5) * * *

(iv) Directory of WHMT trustees and NMWHFITs. The IRS provides a directory of WHMT trustees and NMWHFITs, and WHMT trustees provide an Internet website at which the trustees list the WHMTs for which they act, to assist requesting persons in locating a representative of a WHFIT that will provide the information specified in paragraph (c) of this section. A requesting person may report consistent with this section for any arrangement identified in the directory as a NMWHFIT or on a WHMT trustee's Internet website as a WHMT provided that the requesting person does not have actual knowledge that the arrangement is not a WHFIT.

(f) * * *

(1) * * *

(i) * * *

(A) [The text of proposed §1.671-5(f)(1)(i)(A) is the same as the text of §1.671-5T(f)(1)(i)(A) published elsewhere in this issue of the **Federal Register**].

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(viii) Reporting market discount information under the safe harbor -- (A) In general -- (1) Trustee is required to provide market discount information. If the trustee is required to provide information regarding market discount under paragraph (c)(2)(vii) of this section, the trustee must provide--

(i) The information required to be provided under paragraph (f)(1)(iv)(A)(1)(iii) of this section; and

(ii) If the NMWHFIT holds debt instruments with OID and the NMWHFIT has a start-up date on or after January 24, 2006, the aggregate adjusted issue price of the debt instruments per trust interest calculated as of the start-up date and as of January 1 for each subsequent year of the NMWHFIT.

(2) Trustee is not required to provide market discount information. If the trustee is not required to provide market discount information under paragraph (c)(2)(vii) of this section (because the NMWHFIT meets the de minimis test of paragraph (c)(2)(iv)(D)(1) of this section, the qualified NMWHFIT exception of

paragraph (c)(2)(iv)(E) of this section, or the NMWHFIT final year exception of paragraph (c)(2)(iv)(F) of this section), the trustee is not required under this paragraph (f) to provide any information regarding market discount.

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Deputy Commissioner for Services and Enforcement.